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BEFORE THE ARIZONA CORPORATION COMMISSION

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2007 OCT 29 P 12:00

AZ CORP COMMISSION
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY
FOR A DETERMINATION OF THE
CURRENT FAIR VALUE OF ITS UTILITY
PLANT AND PROPERTY AND FOR
INCREASES IN ITS RATES AND CHARGES
BASED THEREON FOR UTILITY SERVICE
BY ITS SUN CITY WATER DISTRICT.

DOCKET NO. W-01303A-07-0209

**NOTICE OF FILING
STAFF'S DIRECT TESTIMONY**

Staff of the Arizona Corporation Commission hereby files the following Direct Testimony:

1. Steve P. Irvine's Errata for his cost of capital testimony that was filed on October 15, 2007.
2. Steve P. Irvine's Direct Testimony on Staff's recommended rate design
3. Alexander I. Igwe's Direct Testimony addressing the revision to Staff's recommended revenue requirement, and Staff's analysis and recommendations regarding the Company's request for approval of a Public Safety Surcharge Mechanism

RESPECTFULLY SUBMITTED this 29th day of October, 2007.

Robin R. Mitchell
Attorney, Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007
(602) 542-6024

Arizona Corporation Commission
DOCKETED

OCT 29 2007

DOCKETED BY

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1 Original and thirteen (13) copies
2 of the foregoing were filed this
29th day of October, 2007 with:

3 Docket Control
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5 Phoenix, Arizona 85007

6 Copy of the foregoing mailed this
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27
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DIRECT
TESTIMONY
OF

STEVE P. IRVINE – ERRATA
STEVEN P. IRVINE – RATE DESIGN
ALEXANDER I. IGWE

DOCKET NO. W-01303A-07-0209

IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY
FOR APPROVAL OF THE CURRENT FAIR
VALUE OF ITS UTILITY PLANT AND
PROPERTY AND FOR INCREASES IN ITS
RATES AND CHARGES BASED THEREON
FOR UTILITY SERVICE BY ITS SUN CITY
WATER DISTRICT

OCTOBER 29, 2007

BEFORE THE ARIZONA CORPORATION COMMISSION

MIKE GLEASON

Chairman

WILLIAM A. MUNDELL

Commissioner

JEFF HATCH-MILLER

Commissioner

KRISTIN K. MAYES

Commissioner

GARY PIERCE

Commissioner

IN THE MATTER OF THE APPLICATION OF)
ARIZONA AMERICAN WATER COMPANY)
FOR A DETERMINATION OF THE CURRENT)
FAIR VALUE OF ITS UTILITY PLANT AND)
PROPERTY AND FOR INCREASES IN ITS)
RATES AND CHARGES BASED THEREON)
FOR UTILITY SERVICE BY ITS SUN CITY)
WATER DISTRICT)

DOCKET NO. W-01303A-07-0209

SUPPLEMENTAL DIRECT

TESTIMONY

OF

STEVEN P. IRVINE

PUBLIC UTILITIES ANALYST IV

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

OCTOBER 29, 2007

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EXECUTIVE SUMMARY
ARIZONA-AMERICAN WATER COMPANY
DOCKET NO. W-01303A-07-0209

The Supplemental Direct Testimony of Staff witness Steven P. Irvine addresses the following issues:

Capital Structure – Staff recommends that the Arizona Corporation Commission (“Commission”) adopt a capital structure for Arizona-American Water Company (“Arizona-American” or “Company”) for this proceeding consisting of 61.5 percent debt and 38.5 percent equity.

Cost of Equity – Staff’s recommends that the Commission adopt a 10.8 percent return on equity (“ROE”). Staff’s ROE recommendation includes a 0.9 percent upward adjustment due to the higher financial risk reflected in Arizona-American’s capital structure in relation to that of the sample companies.

Cost of Debt – Staff recommends that the Commission adopt a 5.5 percent cost of debt.

Overall Rate of Return – Staff recommends that the Commission adopt an overall rate of return (“ROR”) of 7.6 percent.

I. INTRODUCTION

Q. Please state your name, occupation, and business address.

A. My name is Steve Irvine. I am a Public Utilities Analyst IV employed by the Arizona Corporation Commission ("ACC" or "Commission") in the Utilities Division ("Staff"). My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

Q. Did you provide prefiled written Direct Testimony in this case previously?

A. Yes. I filed written Direct Testimony on cost of capital October 15, 2007.

Q. What is the purpose of this errata testimony?

A. The purpose of this testimony is to correct Staff's recommended capital structure, cost of debt, rate of return ("ROR"), and supporting figures in Direct Testimony. Staff's initial recommendations and testimony inadvertently included the Tolleson Obligation in calculation of the capital structure, cost of debt, and ROR. In the executive summary of my prefiled Direct Testimony I mentioned this matter and the need to file this errata testimony.

Q. What parts of the Direct Testimony are affected by these changes?

A. Schedule SPI-1, Table 3, and other parts of the testimony that make reference to Staff's recommended cost of debt, capital structure, and ROR are affected. Schedule SPI-1 should be replaced with Supplemental Direct Schedule SPI-1 contained in this errata testimony. Supplemental Direct Schedule SPI-9 contained in this testimony is also included to depict the capital structure, cost of debt, cost of equity and ROR should the Commission choose to include the Tolleson Obligation in the capital structure. Supplemental Direct Schedule SPI-10 depicts the calculation of cost of debt and capital

structure having included the Tolleson Obligation. Supplemental Direct Schedule SPI-11 depicts the same information having excluded the Tolleson Obligation. Supplemental Table 3 shown below replaces Table 3 originally included in Direct Testimony.

Supplemental Table 3

Applicant's Cost of Debt (Excluding the Tolleson Obligation)				
	<u>Amount Outstanding</u> <u>as of 6/30/2007</u>	<u>Annual Interest</u>	<u>Interest Rate</u>	<u>Weight</u>
Long-Term Debt				
Aug '08 L-T Senior Notes	\$ 4,500,000	\$320,490	7.122%	
Sept '13 PILR - Monterey	41,323	2,587	6.260%	
Aug '13 PILR - Montex/Lincoln	23,036	1,327	5.761%	
Aug '15 PILR - Rosalee	43,340	3,112	7.180%	
Aug '15 PILR - T.O. Development	37,123	2,665	7.179%	
Sept '28 L-T Note - Maricopa	10,635,000	386,051	3.630%	
Dec '13 L-T Promissory Note	24,700,000	1,331,330	5.390%	
Dec '16 L-T Promissory Note	11,200,000	618,240	5.520%	
Dec '18 L-T Promissory Note	123,100,000	6,918,220	5.620%	
Fall 2037 L-T Promissory Note	10,000,000	595,000	5.950%	
Fall 2037 L-T Promissory Note Phoenix Interconnection Agreement	6,450,000 2,000,000	383,775 -	5.950% 0.000%	
Long-Term Debt	192,729,822	10,562,796	5.481%	54.3%
Short-Term Debt				
Short-Term Debt	24,391,823	1,327,891	5.444%	

Phoenix Interconnection Agreement	1,000,000	-	0.000%	
Short-Term Debt	25,391,823	1,327,891	5.230%	7.2%
Total Debt	\$ 218,121,645	\$11,890,687	5.451%	61.5%
Applicant's Equity				
			<u>Amount outstanding</u> <u>as of 6/30/2007</u>	
Common Equity				
Common Stock			522,880	
Paid in Capital			149,468,228	
Retained Earnings			(28,250,298)	
2007 Equity Infusion			15,000,000	
Total Common Equity			\$ 136,740,810	38.5%
Total Capitalization			\$ 354,862,455	100%

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II. RECOMMENDATIONS

Q. What is Staff's recommended capital structure?

A. Staff's capital structure recommendation is 61.5 percent debt and 38.5 percent equity as shown in Errata Schedule 1 and Supplemental Table 3.

Q. What is Staff's recommended cost of debt?

A. Staff's cost of debt is 5.5 percent as shown in Supplemental Direct Schedule 1.

1 **Q. What is Staff's recommended ROR?**

2 A. Staff's ROR is 7.6 percent as shown in Supplemental Direct Schedule 1.

3

4 **Q. Does this conclude your Supplemental Direct Testimony?**

5 A. Yes, it does.

Sun City Water District
Capital Structure
And Weighted Average Cost of Capital
Staff Recommended and Company Proposed

[A]	[B]	[C]	[D]
<u>Description</u>	<u>Weight (%)</u>	<u>Cost</u>	<u>Weighted Cost</u>
Staff Recommended Structure (excludes Tolleson Obligation)			
Debt	61.5%	5.5% ¹	3.4%
Common Equity	38.5%	10.8% ²	4.2%
Weighted Average Cost of Capital/ROR			<u>7.6%</u>
Company Proposed Structure			
Debt	57.6%	5.6%	3.2%
Common Equity	42.4%	11.3%	4.8%
Weighted Average Cost of Capital/ROR			<u>8.0%</u>

[D] : [B] x [C]

Supporting Schedule: SPI-3

1: Note that the Tolleson Obligation is excluded for the calculation of the cost of debt, resulting in a cost of debt 10 basis points higher than as shown in Schedule SPI-9.

2: Note that the cost of equity depicts the 10.8 percent ROE inclusive of 90 basis points for financial risk as shown in Schedules SPI-9 and SPI-2. If the Commission were to determine that the financial risk adjustment should not include the Tolleson Obligation, the financial risk adjustment would be 80 basis points, resulting in a cost of equity and a rate of return of 10.7 and 7.5 percent, respectively. If the Commission decides to include the Tolleson Obligation in the capital structure, then the cost of equity and rate of return would be 10.8 and 7.4 percent, respectively (As Indicated in SPI-9).

Sun City Water Districts
Capital Structure Including the Tolleson Obligation
And Weighted Average Cost of Capital

[A]	[B]	[C]	[D]
<u>Description</u>	<u>Weight (%)</u>	<u>Cost</u>	<u>Weighted Cost</u>
Structure including Tolleson Obligation	62.4%	5.4% ¹	3.3%
Debt	37.6%	10.8%	4.1%
Weighted Average Cost of Capital/ROR			<u>7.4%</u>

[D] : [B] x [C]

1: Note that the Tolleson Obligation is included for the calculation of the cost of debt, resulting in a cost of debt 10 basis points lower than as shown in Schedule SPI-1.

Applicant's Cost of Debt (Including the Tolleson Obligation)				
	<u>Amount outstanding</u> <u>as of 6/30/2007</u>	<u>Annual Interest</u>	<u>Interest Rate</u>	<u>Weight</u>
Long-Term Debt				
Aug '08 L-T Senior Notes	\$ 4,500,000	320,490	7.122%	
Sept '13 PILR - Monterey	41,323	2,587	6.260%	
Aug '13 PILR - Montex/Lincoln	23,036	1,327	5.761%	
Aug '15 PILR - Rosalee	43,340	3,112	7.180%	
Aug '15 PILR - T.O. Development	37,123	2,665	7.179%	
Sept '28 L-T Note - Maricopa	10,635,000	386,051	3.630%	
Dec '13 L-T Promissory Note	24,700,000	1,331,330	5.390%	
Dec '16 L-T Promissory Note	11,200,000	618,240	5.520%	
Dec '18 L-T Promissory Note	123,100,000	6,918,220	5.620%	
Fall 2037 L-T Promissory Note	10,000,000	595,000	5.950%	
Fall 2037 L-T Promissory Note	6,450,000	383,775	5.950%	
Tolleson Obligation ²	8,560,000	280,768	3.280%	
Phoenix Interconnection Agreement	2,000,000	-	0.000%	
Long-Term Debt	201,289,822	10,843,564	5.387%	55.4%
Short-Term Debt				
Short-Term Debt	24,391,823	1,327,891	5.444%	
Phoenix Interconnection Agreement	1,000,000	-	0.000%	
Short-Term Debt	25,391,823	1,327,891	5.230%	7.0%
Total Debt	\$ 226,681,645	\$ 12,171,455	5.369%	62.4%

Applicant's Equity		
	<u>Amount outstanding</u> <u>as of 6/30/2007</u>	
Common Equity		
Common Stock	522,880	
Paid in Capital	149,468,228	
Retained Earnings	(28,250,298)	
2007 Equity Infusion	15,000,000	
Total Common Equity	\$ 136,740,810	37.6%
Total Capitalization	\$ 363,422,455	100%

Applicant's Cost of Debt (Excluding the Tolleson Obligation)				
	<u>Amount outstanding</u> <u>as of 6/30/2007</u>	<u>Annual Interest</u>	<u>Interest Rate</u>	<u>Weight</u>
Long-Term Debt				
Aug '08 L-T Senior Notes	\$ 4,500,000	320,490	7.122%	
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Aug '15 PILR - Rosalee	43,340	3,112	7.180%	
Aug '15 PILR - T.O. Development	37,123	2,665	7.179%	
Sept '28 L-T Note - Maricopa	10,635,000	386,051	3.630%	
Dec '13 L-T Promissory Note	24,700,000	1,331,330	5.390%	
Dec '16 L-T Promissory Note	11,200,000	618,240	5.520%	
Dec '18 L-T Promissory Note	123,100,000	6,918,220	5.620%	
Fall 2037 L-T Promissory Note	10,000,000	595,000	5.950%	
Fall 2037 L-T Promissory Note	6,450,000	383,775	5.950%	
Phoenix Interconnection Agreements	2,000,000	-	0.000%	
Long-Term Debt	192,729,822	10,562,796	5.481%	54.3%
Short-Term Debt				
Short-Term Debt	24,391,823	1,327,891	5.444%	
Phoenix Interconnection Agreements	1,000,000	-	0.000%	
Short-Term Debt	25,391,823	1,327,891	5.230%	7.2%
Total Debt	\$ 218,121,645	\$ 11,890,687	5.451%	61.5%

Applicant's Equity		
	<u>Amount outstanding</u> <u>as of 6/30/2007</u>	
Common Equity		
Common Stock	522,880	
Paid in Capital	149,468,228	
Retained Earnings	(28,250,298)	
2007 Equity Infusion	15,000,000	
Total Common Equity	\$ 136,740,810	38.5%
Total Capitalization	\$ 354,862,455	100%

BEFORE THE ARIZONA CORPORATION COMMISSION

MIKE GLEASON

Chairman

WILLIAM A. MUNDELL

Commissioner

JEFF HATCH-MILLER

Commissioner

KRISTIN K. MAYES

Commissioner

GARY PIERCE

Commissioner

IN THE MATTER OF THE APPLICATION OF)
ARIZONA-AMERICAN WATER COMPANY)
FOR APPROVAL OF THE CURRENT FAIR)
VALUE OF ITS UTILITY PLANT AND)
PROPERTY AND FOR INCREASES IN ITS)
RATES AND CHARGES BASED THEREON)
FOR UTILTIY SERVICE BY ITS SUN CITY)
WATER DISTRICT)

DOCKET NO. W-01303A-07-0209

DIRECT

TESTIMONY

OF

STEVE IRVINE

PUBLIC UTILITIES ANALYST IV

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

OCTOBER 29, 2007

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EXECUTIVE SUMMARY
ARIZONA-AMERICAN WATER COMPANY
DOCKET NO. W-01303A-07-0209

On April 2, 2007, Arizona-American Water Company ("Arizona-American" or "Company") filed a revised general rate application. Arizona-American is a for profit company providing water to approximately 23,000 customers in the towns of Sun City and Youngtown. The testimony of Mr. Steve Irvine presents Staff's recommend rate design.

The present rate design is based on minimum monthly charges that generally increase by meter size. For the most part, customers are distinguished by meter size of which there are seven currently serving residential and commercial customers. In addition to the monthly minimum charge residential and commercial customers pay a tiered commodity rate. The 5/8-inch and 3/4-inch residential classes include a three-tiered commodity rate. Each of the other residential and commercial classes has two-tiered commodity rates. Currently no gallons are included in the minimum charges. Irrigation, Private Fire and Public Interruptible classes pay a monthly minimum and a flat rate rather than tiered commodity rate. Central Arizona Project water is sold with no minimum charge and a flat commodity rate.

The Company proposes to keep the same rate structure for all classes. The Company's proposed rates spread the proposed increase in revenue across all the customer classes. The increase is accomplished by increasing monthly usage charges and commodity charges. No change is proposed by the Company for miscellaneous service charges.

Staff recommends a comparable rate structure to that currently in place. The exception is that many of the thresholds are reduced to encourage more efficient use of water. Staff recommends a three-tier inverted block rate structure for the residential 5/8-inch and 3/4-inch customer classes with break-over points at 3,000 gallons and at 10,000 gallons. Staff recommends a two-tier inverted block rate structure for each of the commercial meter sizes and for each of the residential meters that are larger than 3/4-inch. Staff's methodology for determination of monthly minimum charges is based on the volumetric capacity of each class's meter size and generally increases proportionally to the capacity for each meter size. Staff's recommended rate design would generate Staff's recommended revenue requirement of \$9,602,228, including \$9,492,185 from metered water sales. Metered water revenue of \$9,492,185 represents a 25 percent increase over the Test Year metered water revenue. The typical 5/8-inch meter residential bill with median use of 6,431 gallons would increase by \$2.84, or 23.89 percent, from \$11.88 to \$14.72.

INTRODUCTION

Q. Please state your name, occupation, and business address.

A. My name is Steve Irvine. I am a Public Utilities Analyst IV employed by the Arizona Corporation Commission ("ACC" or "Commission") in the Utilities Division ("Staff"). My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

Q. Briefly describe your responsibilities as a Public Utilities Analyst.

A. In my capacity as a Public Utilities Analyst, I conduct studies to estimate the cost of capital component and determine the overall revenue requirement in rate proceedings. I also design rates to generate the revenue requirement in rate proceedings.

Q. Please describe your educational background and professional experience.

A. In 1994, I graduated from Arizona State University, receiving a Bachelor of Science degree in Business Marketing. In 1997, I received a Masters degree in Public Administration from Arizona State University. I began employment with the Commission in May of 2001 and have worked in the Utilities Division since September of 2002.

Q. What is the scope of your testimony in this case?

A. My testimony provides Staff's recommended rate design for Arizona-American Water Company ("Arizona-American" or "Company") in this case.

Q. Have you reviewed the application submitted by Arizona-American in this case?

A. Yes.

SUMMARY OF TESTIMONY AND RECOMMENDATIONS

Q. Briefly summarize how your Rate Design Testimony is organized.

A. Staff's rate design testimony is organized to present a discussion of the present rates, the Company's proposed rates, and Staff's recommended rates for Arizona-American. Schedules SPI-1 and SPI-2 are provided to further describe Staff's rate design.

Present Rate Design

Q. Please provide an overview of the Company's present rates.

A. The following is a general description of the present rate design. Details of the rate designs are presented on Staff's Direct Testimony Schedule SPI-1. The present rate design is based on minimum monthly charges that generally increase by meter size. The exception is that both 5/8-inch and 3/4-inch residential customers have the same \$6.33 monthly minimum. For the most part customers are distinguished by meter size of which there are seven currently serving residential and commercial customers. In addition to the monthly minimum charge, residential and commercial customers pay a tiered commodity rate. The 5/8-inch and 3/4-inch residential classes include a three-tiered commodity rate. Each of the other residential and commercial classes has two-tiered commodity rates. Currently no gallons are included in the minimum charges. Irrigation, Private Fire and Public Interruptible classes pay a monthly minimum and a flat rate rather than tiered commodity rate. Central Arizona Project water is sold with no minimum charge and a flat commodity rate.

The Company's Proposed Rate Design

Q. Please provide an overview of the Company's proposed rate structure.

A. The Company proposes to keep the same rate structure for all classes. The Company's proposed rates spread the proposed increase in revenue across all the customer classes.

1 The increase is accomplished by increasing monthly usage charges and commodity
2 charges. No change is proposed by the Company for miscellaneous service charges.

3
4 **Q. Has the Company submitted a recommendation for the format and content of its**
5 **tariff's in addition to rates and charges?**

6 A. No. No proposal for the format or content of the tariffs was included in the application
7 except for the specific rate recommendations made by the Company.

8
9 **Staff's Recommended Rate Design**

10 **Q. In addition to maintaining non-discriminatory rates that provide Staff's**
11 **recommended revenue and other issues such as gradualism, revenue stability, and**
12 **customer affordability, what policy objectives are reflected in Staff's recommended**
13 **rates?**

14 A. Staff's rate design recognizes the growing importance of managing water as a finite
15 resource and its increasing cost. The quantity of water resources available to Arizona and
16 in the Company's service territories does not grow with population and customer base,
17 and the cost of developing, treating, and delivering water increases with diminishing
18 supply and increased health and safety regulations. Staff recommends a rate design that
19 encourages efficient use of water.

20
21 **Q. Please provide a description of Staff's recommended rate structure for the water**
22 **system.**

23 A. Staff recommends a comparable rate structure to that currently in place. The exception is
24 that many of the thresholds are reduced to encourage more efficient use of water. Staff
25 recommends a three-tier inverted block rate structure for the residential 5/8-inch and 3/4-
26 inch customer classes with break-over points at 3,000 gallons and at 10,000 gallons. Staff

1 recommends a two-tier inverted block rate structure for each of the commercial meter
2 sizes and for each of the residential meters that are larger than 3/4-inch. The
3 recommended break-over points increase with meter size as shown in Schedule SPI-1.
4 Under the recommended rate design, the monthly bill at any usage level is higher for a
5 larger meter than for a smaller meter. Staff agrees with the Company's proposal to
6 continue to not include any gallons in the minimum monthly charge. This will serve to
7 eliminate the implication that any water is free and to send an appropriate economic signal
8 to customers for all consumption.

9
10 **Q. Is Staff recommending an inverted tier block rate structure for all customer classes?**

11 A. No. Staff recommends inverted tier block rates for residential and commercial classes, but
12 recommends that the other classes continue to have a flat commodity rate.

13
14 **Q. Please describe the basis for Staff's recommended monthly minimum charges and
15 commodity rates?**

16 A. The monthly minimum charges and commodity rates recommended by Staff in this case
17 are based on a methodology relied on by Staff regularly in water rate cases. These Staff
18 recommendations have been regularly adopted by the Commission. Staff's methodology
19 for determination of monthly minimum charges is based on the volumetric capacity of
20 each class's meter size and generally increases proportionally to the capacity for each
21 meter size. This method is generally not applied to standpipe, interruptible, and wholesale
22 rates. Staff's rate design encourages more efficient use of water because the second tier
23 rate for 5/8-inch meter customers is greater than the rate that would be required to recover
24 the revenue requirement using a uniform commodity rate. As a result, customers
25 experience a greater incremental cost for all use exceeding 3,000 gallons for this size

meter. The concept for 5/8-inch meters is extended to customers with larger meters where the break-over points graduate in correlation with meter size.

Q. Did Staff prepare schedules showing the present, Company proposed, and Staff recommended monthly minimums and commodity rates for each rate class?

A. Yes. Staff's Direct Testimony Schedule SPI-1 shows the present monthly minimum charges and commodity rates, the Company's proposed monthly minimum charges and commodity rates and Staff's recommended monthly minimum charges and commodity rates.

Q. Did Staff prepare a schedule showing the average and median monthly bill under present rates, the Company's proposed rates, and Staff's recommended rates?

A. Yes. Staff's Direct Testimony Schedule SPI-2 presents the average and median monthly bill using present rates, the Company's proposed rates and Staff's recommended rates.

Q. What water system service charges does Staff recommend?

A. Staff's recommendations for service charges are shown in Schedule SPI-1.

Q. Will Staff's recommended rate design generate Staff's recommended revenue requirement?

A. Staff's recommended rate design would generate Staff's recommended revenue requirement of \$9,602,228 including \$9,492,185 from metered water sales. Metered water revenue of \$9,492,185 represents a 25 percent increase over the Test Year metered water revenue.

1 **Q. Does this conclude your Direct Testimony?**

2 **A. Yes, it does.**

RATE DESIGN

Monthly Usage Charge	Present Rates	Company Proposed Rates	Staff Recommended Rates
5/8" Meter - Residential	\$ 6.33	\$ 8.20	\$ 8.00
3/4" Meter - Residential	6.33	8.20	8.00
1" Meter - Residential	16.40	20.50	20.50
1 1/2" Meter - Residential	33.77	41.00	41.00
2" Meter - Residential	51.14	65.60	65.60
3" Meter - Residential	86.84	131.20	131.20
4" Meter - Residential	135.00	205.00	205.00
6" Meter - Residential	178.51	410.00	410.00
8" Meter - Residential	350.00	656.00	656.00
5/8" Meter - Commercial	\$ 6.33	\$ 8.20	\$ 8.00
3/4" Meter - Commercial	6.33	8.20	8.00
1" Meter - Commercial	16.40	20.50	20.50
1 1/2" Meter - Commercial	33.77	41.00	41.00
2" Meter - Commercial	51.14	65.60	65.60
3" Meter - Commercial	86.84	131.20	131.20
4" Meter - Commercial	135.00	205.00	205.00
6" Meter - Commercial	178.51	410.00	410.00
8" Meter - Commercial	350.00	656.00	656.00
Irrigation 1"	16.46	20.50	20.50
Irrigation 1.5"	33.78	41.00	41.00
Irrigation 2"	51.15	65.60	65.60
Irrigation 3"	86.87	131.20	131.20
Irrigation 4"	135.00	205.00	205.00
Irrigation 6"	178.56	410.00	410.00
Private Fire 3"	7.60	11.48	11.18
Private Fire 4"	11.39	17.30	17.30
Private Fire 6"	15.83	36.35	36.35
Private Fire 8"	25.32	47.46	47.46
Private Fire 10"	39.35	68.34	68.34
Public Interruptible 3"	4.59	6.93	6.93
Public Interruptible 8"	4.59	6.93	6.93
Standby - City of Peoria	4.62	6.98	6.98
Central Arizona Project Raw	-	-	-
Commodity Rates			
5/8" Meter (Residential)			
From 1 to 4,000 Gallons	\$ 0.7200	\$ 0.9350	N/A
From 4,001 to 18,000 Gallons	\$ 1.1000	\$ 1.4280	N/A
Over 18,000 Gallons	\$ 1.3160	\$ 1.7100	N/A
From 1 to 3,000 Gallons	N/A	N/A	\$ 0.7200
From 3,001 to 10,000 Gallons	N/A	N/A	\$ 1.3300
Over 10,000 Gallons	N/A	N/A	\$ 1.6600
3/4" Meter (Residential)			
From 1 to 4,000 Gallons	\$ 0.7200	\$ 0.9350	N/A
From 4,001 to 18,000 Gallons	\$ 1.1000	\$ 1.4280	N/A
Over 18,000 Gallons	\$ 1.3160	\$ 1.7100	N/A
From 1 to 3,000 Gallons	N/A	N/A	\$ 0.7200
From 3,001 to 10,000 Gallons	N/A	N/A	\$ 1.3300
Over 10,000 Gallons	N/A	N/A	\$ 1.6600
5/8" Meter (Commercial)			
From 1 to 18,000 Gallons	\$ 1.1000	\$ 1.4280	N/A
Over 18,000 Gallons	\$ 1.3160	\$ 1.7100	N/A
From 1 to 10,000 Gallons	N/A	N/A	\$ 1.3300
Over 10,000 Gallons	N/A	N/A	\$ 1.6600

Monthly Usage Charge	Present Rates	Company Proposed Rates	Staff Recommended Rates
3/4" Meter (Commercial)			
From 1 to 18,000 Gallons	\$ 1.1000	\$ 1.4280	N/A
Over 18,000 Gallons	\$ 1.3160	\$ 1.7100	N/A
From 1 to 10,000 Gallons	N/A	N/A	\$ 1.3300
From 10,001 to 10,000 Gallons	N/A	N/A	\$ 1.6600
1" Meter (Res., Comm.)			
From 1 to 60,000 Gallons	\$ 1.1000	\$ 1.4280	N/A
Over 60,000 Gallons	\$ 1.3160	\$ 1.7100	N/A
From 1 to 46,000 Gallons	N/A	N/A	\$ 1.3300
Over 46,000 Gallons	N/A	N/A	\$ 1.6600
1 1/2" Meter (Res., Comm.)			
From 1 to 125,000 Gallons	\$ 1.1000	\$ 1.4280	N/A
Over 125,000 Gallons	\$ 1.3160	\$ 1.7100	N/A
From 1 to 106,000 Gallons	N/A	N/A	\$ 1.3300
Over 106,000 Gallons	N/A	N/A	\$ 1.6600
2" Meter (Res., Comm.)			
From 1 to 190,000 Gallons	\$ 1.1000	\$ 1.4280	N/A
Over 190,000 Gallons	\$ 1.3160	\$ 1.7100	N/A
From 1 to 175,000 Gallons	N/A	N/A	\$ 1.3300
Over 175,000 Gallons	N/A	N/A	\$ 1.6600
3" Meter (Res., Comm.)			
From 1 to 340,000 Gallons	\$ 1.1000	\$ 1.4280	N/A
Over 340,000 Gallons	\$ 1.3160	\$ 1.7100	N/A
From 1 to 340,000 Gallons	N/A	N/A	\$ 1.3300
Over 340,000 Gallons	N/A	N/A	\$ 1.6600
4" Meter (Res., Comm.)			
From 1 to 550,000 Gallons	\$ 1.1000	\$ 1.4280	N/A
Over 550,000 Gallons	\$ 1.3160	\$ 1.7100	N/A
From 1 to 550,000 Gallons	N/A	N/A	\$ 1.3300
Over 550,000 Gallons	N/A	N/A	\$ 1.6600
6" Meter (Res., Comm.)			
From 1 to 700,000 Gallons	\$ 1.1000	\$ 1.4280	N/A
Over 700,000 Gallons	\$ 1.3160	\$ 1.7100	N/A
From 1 to 700,000 Gallons	N/A	N/A	\$ 1.3300
Over 700,000 Gallons	N/A	N/A	\$ 1.6600
8" Meter (Res., Comm.)			
From 1 to 1,450,000 Gallons	\$ 1.1000	\$ 1.4280	N/A
Over 1,450,000 Gallons	\$ 1.3160	\$ 1.7100	N/A
From 1 to 1,430,000 Gallons	N/A	N/A	\$ 1.3300
Over 1,430,000 Gallons	N/A	N/A	\$ 1.6600
Irrigation 1"			
All Gallons	\$ 0.8200	\$ 1.0645	\$ 1.0645
Irrigation 1.5"			
All Gallons	0.8200	1.0645	1.0645
Irrigation 2"			
All Gallons	0.8200	1.0645	1.0645
Irrigation 3"			
All Gallons	0.8200	1.0645	1.0645
Irrigation 4"			
All Gallons	0.8200	1.0645	1.0645
Irrigation 6"			
All Gallons	0.8200	1.0645	1.0645
Private Fire 3"	0.7600	0.9866	0.9866
All Gallons			
Private Fire 4"	0.7600	0.9866	0.9866
All Gallons			
Private Fire 6"	0.7600	0.9866	0.9866
All Gallons			
Private Fire 8"	0.7600	0.9866	0.9866
All Gallons			
Private Fire 10"	0.7600	0.9866	0.9866
All Gallons			
Public Interruptible 3"			
All Gallons	\$ 0.6300	\$ 0.8179	\$ 0.9866
Public Interruptible 8"			
All Gallons	0.6300	0.8179	0.9866
Standby - City of Peoria			
All Gallons	0.7600	0.9866	0.9866
Central Arizona Project Raw			
All Gallons	0.6558	0.8513	0.8513

(a) Per Commission Rule A.A.C. R-14-2-403B
(b) Per Commission Rule A.A.C. R-14-2-409D

TYPICAL BILL ANALYSIS AVERAGE AND MEDIAN COST COMPARISONS

LINE NO.	CUSTOMER CLASS	CURRENT RATES			
		AVERAGE		MEDIAN	
		USAGE	DOLLARS	USAGE	DOLLARS
1	Residential 5/8"	8,269	\$ 13.91	6,431	\$ 11.88
2	Residential 3/4"	8,269	\$ 13.91	6,431	\$ 11.88
3	Residential 1"	19,791	\$ 38.17	8,586	\$ 25.84
4	Residential 1.5"	71,637	\$ 112.57	57,843	\$ 97.40
5	Residential 2"	91,303	\$ 151.57	63,613	\$ 121.11
6	Residential 3"	204,575	\$ 311.87	210,281	\$ 318.15
7	Residential 4"	N/A	N/A	N/A	N/A
8	Residential 6"	81,513	\$ 268.17	44,500	\$ 227.46
9	Residential 8"	N/A	N/A	N/A	N/A
10					
11	Commerical 5/8"	6,722	\$ 13.72	1,230	\$ 7.68
12	Commercial 3/4"	6,722	\$ 13.72	1,230	\$ 7.68
13	Commerical 1"	21,916	\$ 40.51	9,650	\$ 27.02
14	Commerical 1.5"	51,027	\$ 89.90	19,188	\$ 54.88
15	Commerical 2"	103,262	\$ 164.73	58,278	\$ 115.25
16	Commerical 3"	253,459	\$ 365.64	96,000	\$ 192.44
17	Commercial 4"	957,823	\$ 1,276.70	773,500	\$ 1,034.13
18	Commercial 6"	3,365,733	\$ 4,456.61	1,212,500	\$ 1,622.96
19	Commercial 8"	N/A	N/A	N/A	N/A
20					
21	Irrigation 1"	290,865	\$ 254.97	225,500	\$ 201.37
22	Irrigation 1.5"	N/A	N/A	N/A	N/A
23	Irrigation 2"	364,664	\$ 350.17	34,500	\$ 79.44
24	Irrigation 3"	N/A	N/A	N/A	N/A
25	Irrigation 4"	N/A	N/A	N/A	N/A
26	Irrigation 6"	N/A	N/A	N/A	N/A
27					
28	Private Fire 3"	-	\$ 7.60	-	\$ 7.60
29	Private Fire 4"	-	\$ 11.39	-	\$ 11.39
30	Private Fire 6"	-	\$ 15.83	-	\$ 15.83
31	Private Fire 8"	-	\$ 25.32	-	\$ 25.32
32	Private Fire 10"	N/A	N/A	N/A	N/A
33					
34	Public Interruptible 3"	N/A	N/A	N/A	N/A
35	Public Interruptible 8"	-	\$ 4.59	-	\$ 4.59
36	Standby - City of Peoria	N/A	N/A	N/A	N/A
37	Central Arizona Project Raw	547,698	\$ 359.18	70,214	\$ 46.05
38					

*Average and median billing data for 5/8" and 3/4" has been combined

LINE NO.	CUSTOMER CLASS	COMPANY RECOMMENDED					
		AVERAGE			MEDIAN		
		AVERAGE	CHANGE	PERCENT	MEDIAN	CHANGE	PERCENT
39	Residential 5/8"	\$ 18.04	\$ 4.13	29.70%	\$ 15.41	\$ 3.53	29.68%
40	Residential 3/4"	\$ 18.04	\$ 4.13	29.70%	\$ 15.41	\$ 3.53	29.68%
41	Residential 1"	\$ 48.76	\$ 10.59	27.75%	\$ 32.76	\$ 6.92	26.76%
42	Residential 1.5"	\$ 143.30	\$ 30.73	27.30%	\$ 123.60	\$ 26.20	26.90%
43	Residential 2"	\$ 195.98	\$ 44.41	29.30%	\$ 156.44	\$ 35.33	29.17%
44	Residential 3"	\$ 423.33	\$ 111.46	35.74%	\$ 431.48	\$ 113.33	35.62%
45	Residential 4"	N/A	N/A	N/A	N/A	N/A	N/A
46	Residential 6"	\$ 526.40	\$ 258.23	96.29%	\$ 473.55	\$ 246.09	108.19%
47	Residential 8"	N/A	N/A	N/A	N/A	N/A	N/A
48							
49	Commerical 5/8"	\$ 17.80	\$ 4.07	29.69%	\$ 9.96	\$ 2.27	29.59%
50	Commercial 3/4"	\$ 17.80	\$ 4.07	29.69%	\$ 9.96	\$ 2.27	29.59%
51	Commerical 1"	\$ 51.80	\$ 11.29	27.87%	\$ 34.28	\$ 7.27	26.89%
52	Commerical 1.5"	\$ 113.87	\$ 23.97	26.66%	\$ 68.40	\$ 13.52	24.64%
53	Commerical 2"	\$ 213.06	\$ 48.33	29.34%	\$ 148.82	\$ 33.58	29.13%
54	Commerical 3"	\$ 493.14	\$ 127.49	34.87%	\$ 268.29	\$ 75.85	39.41%
55	Commercial 4"	\$ 1,687.78	\$ 411.08	32.20%	\$ 1,372.59	\$ 338.46	32.73%
56	Commercial 6"	\$ 5,968.00	\$ 1,511.39	33.91%	\$ 2,285.98	\$ 663.02	40.85%
57	Commercial 8"	N/A	N/A	N/A	N/A	N/A	N/A
58							
59	Irrigation 1"	\$ 330.13	\$ 75.16	29.48%	\$ 260.54	\$ 59.17	29.39%
60	Irrigation 1.5"	N/A	N/A	N/A	N/A	N/A	N/A
61	Irrigation 2"	\$ 453.78	\$ 103.61	29.59%	\$ 102.33	\$ 22.89	28.81%
62	Irrigation 3"	N/A	N/A	N/A	N/A	N/A	N/A
63	Irrigation 4"	N/A	N/A	N/A	N/A	N/A	N/A
64	Irrigation 6"	N/A	N/A	N/A	N/A	N/A	N/A
65							
66	Private Fire 3"	\$ 11.48	\$ 3.88	51.05%	\$ 11.48	\$ 3.88	51.05%
67	Private Fire 4"	\$ 17.30	\$ 5.91	51.89%	\$ 17.30	\$ 5.91	51.89%
68	Private Fire 6"	\$ 36.35	\$ 20.52	129.63%	\$ 36.35	\$ 20.52	129.63%
69	Private Fire 8"	\$ 47.46	\$ 22.14	87.44%	\$ 47.46	\$ 22.14	87.44%
70	Private Fire 10"	N/A	N/A	N/A	N/A	N/A	N/A
71							
72	Public Interruptible 3"	N/A	N/A	N/A	N/A	N/A	N/A
73	Public Interruptible 8"	\$ 6.93	\$ 2.34	50.98%	\$ 6.93	\$ 2.34	50.98%
74	Standby - City of Peoria	N/A	N/A	N/A	N/A	N/A	N/A
75	Central Arizona Project Raw	\$ 466.26	\$ 107.07	29.81%	\$ 59.77	\$ 13.73	29.81%
76							

*Average and median billing data for 5/8" and 3/4" has been combined

LINE NO.	CUSTOMER CLASS	STAFF RECOMMENDED					
		AVERAGE			MEDIAN		
		AVERAGE	CHANGE	PERCENT	MEDIAN	CHANGE	PERCENT
77	Residential 5/8"	\$ 17.17	\$ 3.26	23.46%	\$ 14.72	\$ 2.84	23.89%
78	Residential 3/4"	\$ 17.17	\$ 3.26	23.46%	\$ 14.72	\$ 2.84	23.89%
79	Residential 1"	\$ 46.82	\$ 8.65	22.67%	\$ 31.92	\$ 6.07	23.51%
80	Residential 1.5"	\$ 136.28	\$ 23.71	21.06%	\$ 117.93	\$ 20.53	21.08%
81	Residential 2"	\$ 187.03	\$ 35.46	23.39%	\$ 150.21	\$ 29.09	24.02%
82	Residential 3"	\$ 403.28	\$ 91.41	29.31%	\$ 410.87	\$ 92.72	29.15%
83	Residential 4"	N/A	N/A	N/A	N/A	N/A	N/A
84	Residential 6"	\$ 518.41	\$ 250.24	93.31%	\$ 469.19	\$ 241.73	106.27%
85	Residential 8"	N/A	N/A	N/A	N/A	N/A	N/A
86							
87	Commerical 5/8"	\$ 16.94	\$ 3.22	23.43%	\$ 9.64	\$ 1.95	25.42%
88	Commercial 3/4"	\$ 16.94	\$ 3.22	23.43%	\$ 9.64	\$ 1.95	25.42%
89	Commerical 1"	\$ 49.65	\$ 9.14	22.57%	\$ 33.33	\$ 6.32	23.39%
90	Commerical 1.5"	\$ 108.87	\$ 18.97	21.10%	\$ 66.52	\$ 11.64	21.22%
91	Commerical 2"	\$ 202.94	\$ 38.21	23.20%	\$ 143.11	\$ 27.86	24.18%
92	Commerical 3"	\$ 468.30	\$ 102.66	28.08%	\$ 258.88	\$ 66.44	34.53%
93	Commercial 4"	\$ 1,613.49	\$ 336.79	26.38%	\$ 1,307.51	\$ 273.38	26.44%
94	Commercial 6"	\$ 5,766.12	\$ 1,309.50	29.38%	\$ 2,191.75	\$ 568.79	35.05%
95	Commercial 8"	N/A	N/A	N/A	N/A	N/A	N/A
96							
97	Irrigation 1"	\$ 330.13	\$ 75.16	29.48%	\$ 260.54	\$ 59.17	29.39%
98	Irrigation 1.5"	N/A	N/A	N/A	N/A	N/A	N/A
99	Irrigation 2"	\$ 453.78	\$ 103.61	29.59%	\$ 102.33	\$ 22.89	28.81%
100	Irrigation 3"	N/A	N/A	N/A	N/A	N/A	N/A
101	Irrigation 4"	N/A	N/A	N/A	N/A	N/A	N/A
102	Irrigation 6"	N/A	N/A	N/A	N/A	N/A	N/A
103							
104	Private Fire 3"	\$ 11.18	\$ 3.58	47.11%	\$ 11.18	\$ 3.58	47.11%
105	Private Fire 4"	\$ 17.30	\$ 5.91	51.89%	\$ 17.30	\$ 5.91	51.89%
106	Private Fire 6"	\$ 36.35	\$ 20.52	129.63%	\$ 36.35	\$ 20.52	129.63%
107	Private Fire 8"	\$ 47.46	\$ 22.14	87.44%	\$ 47.46	\$ 22.14	87.44%
108	Private Fire 10"	N/A	N/A	N/A	N/A	N/A	N/A
109							
110	Public Interruptible 3"	N/A	N/A	N/A	N/A	N/A	N/A
111	Public Interruptible 8"	\$ 6.93	\$ 2.34	50.98%	\$ 6.93	\$ 2.34	50.98%
112	Standby - City of Peoria	N/A	N/A	N/A	N/A	N/A	N/A
113	Central Arizona Project Raw	\$ 466.26	\$ 107.07	29.81%	\$ 59.77	\$ 13.73	29.81%
114							

*Average and median billing data for 5/8" and 3/4" has been combined

BEFORE THE ARIZONA CORPORATION COMMISSION

MIKE GLEASON
Chairman
WILLIAM A. MUNDEL
Commissioner
JEFF HATCH-MILLER
Commissioner
KRISTIN K. MAYES
Commissioner
GARY PIERCE
Commissioner

IN THE MATTER OF THE APPLICATION OF) DOCKET NO. W-01303A-07-0209
ARIZONA-AMERICAN WATER COMPANY, AN)
ARIZONA CORPORATION, FOR A)
DETERMINATION OF THE CURRENT FAIR VALUE)
OF ITS UTILITY PLANT AND PROPERTY AND FOR)
INCREASES IN ITS RATES AND CHARGES BASED)
THEREON FOR THE UTILITY SERVICE BY ITS)
SUN CITY WATER DISTRICT)

DIRECT

TESTIMONY

OF

ALEXANDER IBHADE IGWE

EXECUTIVE CONSULTANT III

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

OCTOBER 29, 2007

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EXECUTIVE SUMMARY
ARIZONA-AMERICAN WATER COMPANY – SUN CITY WATER DISTRICT
DOCKET NO. W-01303A-07-0209

On April 2, 2007, Arizona-American Water Company-Sun City Water District ("Sun City Water District" or "Company") filed an application for determination of the current value of its utility plant and property and for increases in its rates and charges. Also, the Company seeks Commission pre-approval of its proposed public safety capital improvements as well as a related surcharge mechanism. Staff's testimony in this instance addresses the Company's request for public safety surcharge mechanism. In addition, Staff addresses a revision to its recommended revenue requirement.

On October 15, 2007, Staff filed its Direct Testimony recommending a revenue requirement of \$9,518,830, based on a rate of return of 7.40 percent. Staff has revised its recommended rate of return to 7.60 percent, resulting in revenue requirement of \$9,602,228. As discussed by Staff Witness, Steve Irvine, Staff's recommended rate design is based on the revised revenue requirement of \$9,602,228.

In Decision No. 67093, beginning at page 59, Line 25, the Commission requested Arizona-American to form a Fire-flow Task Force ("Task Force"), comprised primarily of stakeholders in the towns of Sun City and Youngtown. The Task Force was requested to determine if the "... water production capacity, storage capacity, water lines, water pressure, and fire hydrants of Youngtown and Sun City are sufficient to provide the fire protection capacity that is desired by each community." The Task Force has determined that \$3.1 million of capital investment is required to upgrade Sun City Water District's systems to meet desired fire protection standards. Arizona-American has indicated its desire to implement the Task Force's recommendations. However, the Company states that due to its constrained financial position and the discretionary nature of the required capital investment, Commission pre-authorization of the projects is necessary for it to finance the projects. Also, the Company seeks Commission pre-approval of a public safety surcharge mechanism that would enable it timely recover invested capital costs. Based on the Company's projections, the recommended system improvements will be implemented in phases, commencing from 2009. The Company projects a Step-1 surcharge of \$0.0347 per 1,000-gallons in 2009, culminating in an anticipated Step-4 surcharge of \$0.17 per 1,000-gallons in 2012. Based on a median consumption level of 6,300-gallons, the monthly bill impact would be \$0.11 in 2009, peaking at \$1.07 in 2012. The Company proposes to terminate its proposed public safety surcharge when the capital costs are rate based in its next rate filing.

Staff recommends approval of the Company's proposed public safety surcharge mechanism for Sun City Water District. Staff's recommendation is based on the significant capital improvement required for the systems upgrades, the unique nature of the projects and the reported community support for the recommendations of the Task Force. Staff agrees with the Company that its proposal in this proceeding is similar to Commission approved Arsenic Costs Recovery Mechanism ("ACRM"). As a result, Staff recommends that the Commission impose

the same conditions approved for the ACRM, in Decision No. 66400, on the proposed public safety surcharge mechanism for Sun City Water District.

1 **INTRODUCTION**

2 **Q. Please state your name and business address.**

3 A. My name is Alexander Ibhade Igwe. My business address is 1200 West Washington
4 Street, Phoenix, Arizona 85007.

5
6 **Q. Are you the same Alexander Ibhade Igwe who filed Direct Testimony on rate base
7 and revenue requirement on October 15, 2007?**

8 A. Yes.
9

10 **PURPOSE OF TESTIMONY**

11 **Q. Briefly describe the purpose of your Direct Testimony in this instance.**

12 A. My testimony in this instance addresses:

13 (1) Revision to Staff's recommended revenue requirement and,
14

15 (2) Staff's analysis and recommendations regarding Arizona-American Water
16 Company's ("Arizona-American" or "Company") request for the Arizona
17 Corporation Commission ("Commission") to approve a Public Safety Surcharge
18 Mechanism for its Sun City Water District.
19

20 **REVENUE REQUIREMENT**

21 **Q. What was Staff's recommendation for revenue requirement in its October 15, 2007
22 filing?**

23 A. Staff recommended a revenue requirement of \$9,518,830, based on an overall rate of
24 return of 7.40 percent.
25

1 **Q. Has Staff's recommended rate of return changed since the October 15, 2007 filing?**

2 A. Yes. As indicated in Staff witness, Mr. Steve Irvine's, errata filing, Staff is now
3 recommending a rate of return of 7.60 percent, an increase of 20-basis-points over its
4 previous recommendation of 7.40 percent. Mr. Irvine explains that this change corrects
5 for Staff's inadvertent inclusion of the Tolleson Obligation in its recommended capital
6 structure and cost of debt.

7
8 **Q. What is the impact of Staff's revised rate of return on revenue requirement?**

9 A. Staff's revised rate of return of 7.60 percent results in a revenue requirement of
10 \$9,602,228, an increase of \$83,398 over Staff's prior recommendation of \$9,518,830.
11 Staff's rate design is based on its recalculated revenue requirement of \$9,602,228.

12
13 **Q. Has Staff filed errata schedules to reflect its revision to revenue requirement?**

14 A. No. Staff has determined that it would be more effective to file revised schedules that
15 encompass all necessary revisions with its Surrebuttal Testimony.

16
17 **PUBLIC SAFETY SURCHARGE MECHANISM**

18 **Q. Please provide a brief history regarding Sun City Water District's Public Safety**
19 **proposal.**

20 A. The Commission in Decision No. 67093, beginning at page 59, Line 25, ordered the
21 Company to form a Fire-flow Task Force ("Task Force"), comprised primarily of
22 stakeholders in the towns of Sun City and Youngtown. The Task Force was requested to
23 determine if the "... water production capacity, storage capacity, water lines, water
24 pressure, and fire hydrants of Youngtown and Sun City are sufficient to provide the fire
25 protection capacity that is desired by each community."

1 Pursuant to Decision No. 67093, the Company formed a Fire-flow Task Force ("Task
2 Force"), in October, 2004. The Task Force was comprised of individuals and
3 organizational representatives from both Sun City and Youngtown, including the Sun City
4 Taxpayers Association, Sun City Homeowners Association, the Recreation Centers of Sun
5 City, Sun City Condominium Association, Sun City Fire Department, City of Surprise Fire
6 Department, Youngtown Baptist Village, and Town of Youngtown. The Task Force has
7 concluded that a \$3.1 million capital improvement would be required to upgrade Sun City
8 Water District's systems to meet desired fire protection standards.

9
10 **Q. Does Arizona-American support the recommendations of the Task Force?**

11 A. Yes. Arizona-American agrees with the Task Force that significant capital investments
12 would be required to upgrade its Sun City Water District's systems to enhance fire
13 protection within its certificated area. However, the Company is concerned that it does
14 not yet have the Commission's approval for what it refers to as a discretionary investment
15 program. As a result, the Company is proposing a Sun City Water District Fire flow
16 Surcharge Mechanism ("FCRM") that would enable it commence recovery of the capital
17 costs associated with implementing the Task Force's recommendations, immediately upon
18 completion of each phase of the projects.

19
20 **Q. What is Arizona-American's proposal regarding Sun City Water District's Fire Flow
21 projects?**

22 A. According to Mr. Broderick, starting at page 4 of his Direct Testimony, "Arizona-
23 American asks that the Commission pre-approve certain fire flow improvement projects
24 and also approve an associated rate surcharge mechanism to recover these capital costs."
25 The Company is requesting that the Commission authorize it to engage in the capital

1 improvements recommended by the Task Force, and that the Commission approve a
2 FCRM, which would enable it implement immediate recovery of its investment through a
3 surcharge, when it begins to incur capital costs from 2009.

4
5 **Q. What are the elements of the Company's proposed FCRM for Sun City Water**
6 **District?**

7 A. The Company states that its proposed FCRM is similar to the Commission approved
8 Arsenic Cost Recovery Mechanism ("ACRM"), except that it may have four (4) Step
9 Increases; and an automatic implementation of each Step Increase, 45 days subsequent to
10 each filing. The Company proposes to make a filing for Staff and intervenors review,
11 upon completion of each project phase of the Sun City Water District's public safety
12 projects. Upon filing, Staff and intervenors would have 45 days to recommend changes to
13 its proposed Step Increase. If there are no exceptions to the Company's filing or the
14 exceptions are accepted by the Company, the requested Step Increase will become
15 effective without further Commission action. The Company suggests that its proposal will
16 mitigate delays as experienced by it in the Paradise Valley ACRM Step-1 increase.
17 Finally, the Company proposes to terminate collection of its proposed surcharge, when the
18 capital costs relating to its public safety projects are rate-based in a 2011 rate filing.

19
20 The Company states that if the Commission does not approve its proposed 45-day
21 automatic FCRM implementation clause, the Commission should authorize it to accrue
22 post-in service Allowance for Funds used During Construction ("AFUDC") on the fire
23 flow plant. The Company argues that its proposed post-in service AFUDC will mitigate
24 any harm that could result from regulatory lag.

1 **Q. Why does the Company request Commission approval of a FCRM for its Sun City**
2 **Water District?**

3 A. The Company states the cost of implementing system enhancements for public safety in
4 the Sun City Water District is beyond normal capital improvements necessary for
5 provision of service. Although, the Company suggests that the system enhancements
6 recommended by the Task Force are discretionary, it seems to agree that a significant
7 capital improvement is required to provide adequate fire protection in the Sun City Water
8 District. Further, the Company states that while it is willing to finance the proposed
9 capital improvements, the Commission should approve a FCRM to insure timely recovery
10 of its investment. Mr. Broderick at page 8, states that "Arizona-American's present
11 financial condition is so difficult that it cannot undertake any discretionary capital
12 investment in Arizona without immediate recovery." Another reason for the Company's
13 request is that the substantial capital refund due to Anthem's developer, Pulte Homes, in
14 2008, will strain its cash-flow at the time of the proposed public safety projects.

15
16 **Q. Has the Company examined other means of capital costs recovery beyond its**
17 **proposed surcharge?**

18 A. According to the Company, it analyzed the use of hook-up fees for recovery of its fire
19 flow capital investments in the Sun City Water District. It found that because Sun City
20 Water District is fully built-out and lacks material growth in customer base, the use of a
21 hook-up fee will not be effective for cost recovery.

1 **Q. Has Staff reviewed the Task Force Report regarding Sun City Water District's fire**
2 **flow upgrade?**

3 A. Yes. Staff's engineering analysis indicates that the Task Force recommended system-
4 wide upgrade could adequately alleviate the concerns relating to public safety in the Sun
5 City Water District. Further, Staff found that the Company's proposed fire flow capital
6 improvements could be accomplished at a lesser cost of \$2,670,602, than the proposed
7 \$3.1 million.

8
9 **Q. Does Staff support the Company's request for the Commission to approve a FCRM**
10 **for capital costs recovery outside of a rate-case?**

11 A. Yes. Ordinarily, Staff would be opposed to the Company's request for Commission
12 approval of a mechanism that allows for recovery of plant investment outside of a rate
13 proceeding. Staff finds that the proposed public safety projects are significant in cost and
14 do not constitute normal water system upgrade. Based on the Task Force Report, the
15 proposed fire flow capital improvements seem imperative for public safety in Sun City
16 Water District's certificated area. Further, the Company has indicated its willingness to
17 make the initial investments, as long as it could start recovery of such costs expeditiously.
18 Staff finds that an FCRM would enable the Company to make the necessary investment in
19 the proposed public safety projects in a timely manner. Finally, the reported community
20 support for the proposed public safety projects suggest that there is the desire for the Task
21 Force recommendations to be implemented soon.

1 **Q. What is the anticipated impact of the Company's proposed public safety surcharge**
2 **on ratepayers in the Sun City Water District?**

3 A. The Company estimates that its proposed public safety surcharges will result in rate
4 increases ranging from 2.10 percent in 2009, up to 3.6 percent in 2012, over the current
5 rates. The proposed surcharges, based on the Company's estimated capital costs are
6 \$.0347/1,000-gallons in 2009; \$.072/1,000-gallons in 2010; \$.11/1,000-gallons in 2011;
7 and \$.17/1,000-gallon in 2012. At a median consumption of 6,300-gallons a month, the
8 proposed public safety surcharge will increase rates by \$.11 in 2009 and \$1.07 in 2012.

9
10 **Q. Please comment on the Company's proposed public safety surcharges.**

11 A. The Company's proposed surcharges are based on \$3.1 million capital costs for the public
12 safety system improvements. Based on Staff's proposed capital cost of approximately
13 \$2.6 million, the Company's estimated surcharges will be less than proposed. Except for
14 costs over-run, the Company's proposed surcharges reflect a worst case scenario.

15
16 **Q. What is the Company proposed rate design for its requested FCRM for Sun City**
17 **Water District?**

18 A. The Company proposes to recover its capital costs through a monthly surcharge that is
19 based on consumption levels. In other words, the Company is proposing to recover its
20 capital cost through a FCRM that is solely based on a commodity rate. The Company's
21 proposed surcharge rate will increase upon completion of each phase of the project, to
22 reflect additional capital investment. Staff is not opposed to this proposal. (Staff would
23 note that the Commission in Decision 66400 adopted its recommendation to allow
24 recovery of 50 percent of arsenic improvement capital costs through a monthly surcharge

1 that is based on meter size, while the second 50 percent was assessed through a
2 commodity rate.)
3

4 **Q. Did the Company propose recovery of operating and maintenance costs relating**
5 **public safety protection in this filing?**

6 A. No. Staff's analysis indicates the operating and maintenance costs ("O&M") will be
7 minimal, if any, for the proposed systems upgrade. Unlike arsenic remediation, there will
8 be no costs of media replacement or any known material maintenance costs associated
9 with the proposed projects. Although Staff cannot determine with any certainty, it appears
10 there could be maintenance cost savings resulting from the proposed system
11 improvements. In the event that the Sun City Water District incurs any O&M costs, such
12 costs should be deferred to the next rate case.
13

14 **Q. Please comment on the Company's proposed process for implementing step increases**
15 **through its proposed FCRM.**

16 A. Staff objects to the Company's proposal that its filings for step increases through FCRM
17 be subject to automatic implementation 45 days from the date of filing without further
18 Commission approval. While the Company suggests that this proposal will be appropriate
19 absent of any disagreement between the Company, Staff and intervenors, it did not
20 propose alternate means of resolving disagreements amongst the parties.
21

1 **Q. What is Staff's preferred procedural format for approval of step increases?**

2 A. Staff prefers adoption of the same format approved for ACRM in Decision No. 66400.
3 Staff agrees with the Company's request for a 45 day review period for each step increase.
4 During this review period, Staff and intervenors would have the opportunity to audit the
5 filing and seek additional discovery relating to the Company's proposed Step Increase.
6 Absent any disagreement between the parties, Staff will issue a recommendation for the
7 Commission's approval. In the event of disagreements between the parties, an accelerated
8 hearing may be requested by any party to the proceeding, to examine the disputed issues.
9 If a hearing is held, the Hearing Division will issue a Recommended Order for the
10 Commission's consideration.
11

12 **Q. Did the Company propose an Earnings Test for its suggested Step increases?**

13 A. No.
14

15 **Q. Is Staff recommending an Earnings Test for the Company's proposed Step**
16 **Increases?**

17 A. Yes. Staff recommends that the Commission require the Company to submit the same
18 schedules approved for ACRM, demonstrating Sun City Water District's current earnings,
19 at the time of each filing. Staff's recommended earnings test will enable the Commission
20 to determine if the Sun City Water District is over earning its approved rate of return at the
21 time it files for each Step Increase. If the Commission determines that Sun City Water

1 District is over earning its authorized rate of return, its requested Step Increase will be
2 adjusted to reflect excess earnings.

3
4 **Q. Does Staff recommend any Step Increase filing requirements for the Company's**
5 **proposed FCRM?**

6 A. Yes. Staff recommends the same filing requirements approved for the ACRM, comprised
7 of the following schedules:

- 8 i. The most current balance sheet at the time of filing
- 9 ii. The most current income statement
- 10 iii. An earnings test schedule (consistent with Decision No. 66400)
- 11 iv. A rate review schedule (including the incremental and pro forma effects of
- 12 the proposed increase)
- 13 v. A revenue requirement calculation
- 14 vi. A surcharge calculation
- 15 vii. An adjusted rate base schedule
- 16 viii. A CWIP ledger (for each project showing accumulation of charges by
- 17 month and paid vendor invoices)
- 18 ix. Calculation of the allocation factors
- 19 x. A typical bill analysis under present and proposed rates.
- 20 xi. The Company proposed filing for implementation of a surcharge, upon
- 21 completion of each stage of the project be subject to further approval of the

1 Commission. Further, Staff recommends the Company's filing meet the
2 Earnings Tests adopted by the Commission in Decision No. 66400.

3 **Q. Does this conclude your testimony?**

4 **A. Yes.**